DOCKET FILE COPY ORIGINAL

RECEIVED

JUL 13 1998

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the	)	CC Docket No. 96-128
Pay Telephone Reclassification	)	
and Compensation Provisions of the	)	
Telecommunications Act of 1996	)	

COMMENTS OF THE INTERNATIONAL TELECARD ASSOCIATION

The International Telecard Association ("ITA"),[1] by its attorneys, respectfully submits these comments in the captioned proceeding in response to the Commission's public notice[2] on the recent remand by the U.S. Court of Appeals for the D.C. Circuit in *MCI Telecommunications Corp. v. FCC*.[3]

INTRODUCTION AND SUMMARY

Over the past 28 months the Commission has vainly attempted to develop a "market-based" approach to payphone compensation under Section 276 of the Telecommunications Act of 1996 (47 U.S.C. § 276). These efforts have been and will remain futile. The Commission will continue to fail because there is no competitive market for payphone access and there will not be a competitive market anytime in the near future. Rather than continue this endless struggle to

---

[1] ITA is the principal trade association for the prepaid phonecard, or "telecard," industry with, and has been active in this proceeding since it was opened. Econophone and ITA members who are Regional Bell Operating Companies do not join in these comments.

[2] Public Notice, *Pleading Cycle Established for Comment on Remand Issues In the Payphone Proceeding*, CC Docket No. 96-128, DA 98-1198, June 19, 1998 ("Notice").

[3] *MCI Telecommunications Corp. v. FCC*, No. 96-1675, slip op. (D.C. Cir. May 19, 1998) ("Opinion"). This is the second time in a year that the Commission's payphone compensation rules have been reversed and re-manded by the court of appeals. *Illinois Public Telecommunications Ass'n v. FCC*, 117 F.3d 555, *clarified*, 123 F.3d 693 (D.C. Cir. 1997).

justify a competitive market that does not exist—due to significant payphone locational monopolies and the "lock in" of consumers and interexchange carriers to payphone service providers ("PSP")—the Commission instead should abandon the market-based approach and adopt a cost-based model for payphone compensation that will be simpler, more efficient, more effective and more likely to pass the scrutiny of the federal courts.

The Commission should also discard its "carrier-pays" approach to payphone compensation in favor of a caller-pays method. ITA originally was a strong supporter of the carrier-pays methodology because it believed this would provide administrative and cost efficiencies, while minimizing payphone compensation rates. In fact, however, implementation of carrier-pays has proven to be confusing, costly and inefficient because of the lack of billing and collection arrangements and the failure of LECs to pass accurate ANI coding digits identifying payphone calls. Furthermore, many facilities-based IXCs have used the carrier-pays approach as an opportunity to pass through charges to reseller customers that far exceed their own costs. In any event, only a caller-pays model to payphone compensation will promote any competition in payphone access—by providing a clear, consumer-driven incentive to "vote with their feet" and thus encourage PSPs to impose more reasonable charges.

DISCUSSION

I. THE COMMISSION SHOULD DISCARD THE SO-CALLED "MARKET-BASED" APPROACH TO PAYPHONE COMPENSATION BECAUSE THERE IS NOT A COMPETITIVE MARKET FOR PAYPHONE ACCESS

Early in this proceeding the Commission correctly recognized that in the payphone market, "competitive conditions, which are a prerequisite to a deregulatory, market-based approach, do not currently exist and cannot be achieved immediately."[4] The Commission proposed several steps to remedy this situation, but expressed doubts that these actions could be sufficient to achieve a competitive marketplace.[5] The Notice now seeks comment on competition in the payphone market since the deregulation of local coin rates and the impact of deregulation on market structure and costs.[6] Yet many of the steps identified by the Commission in 1996 to promote competition have not yet been, or only very recently were, implemented, and none has as yet had any real impact on the economic structure or operation of the payphone market.[7] For example, significant delays in the transmission of accurate ANI coding digits (sanctioned by Commission waivers) has impeded accurate tracking of payphone calls, thus preventing IXCs from blocking calls originating from payphones.

Without carriers' ability to block calls, the Commission's predicted development of a negotiated, "market-driven" rate for payphone access has simply not materialized. There have been no appreciable negotiations for payphone compensation rates in the last two years. Every PSP of which ITA is aware charges the Commission-prescribed "default" rate, and the major

[4] *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, Report and Order, 11 FCC Rcd 20541, ¶ 59 (1996) ("Payphone Order"); Order on Reconsideration, 11 FCC Rcd 21233 (1996); *rev'd Illinois Public Telecommunications Ass'n v. FCC,* 117 F.3d 555, *modified,* 123 F.3d 693 (D.C. Cir. 1997); Second Report and Order, 13 FCC Rcd 1778 (1997),

[5] Payphone Order at ¶ 61 (The Commission indicated that it would review, at its option, "the deregulation of local coin rates nationwide and determine whether the marketplace disfunctions, such as locational monopolies where the size of the location or the caller's lack of time to identify potential substitute payphones, exist." It further stated that if "we find that the deregulation of local coin rates warrants a modification of our approach to market failures, we may choose, for example, to set a cap on the number of calls subject to compensation from particular payphones to limit the exercise of locational market power.")

[6] Notice at 2.

[7] *See* Brian Krebs, *Getting Nickel-and-Dimed, Technology is About Change – or Lack Thereof – at Pay Phones,* Washington Post, Mar. 30, 1998, at B19 quoting Gene Kimmelman, Executive Director of the Consumer Union ("There is no competition at the consumer level [for payphone calls]. When was the last time you saw two payphones at one location that were each owned by a different company or that charged a different price? It just does not happen.").

PSP associations have been unwilling to entertain proposals for negotiating different payphone rates. (The PSP position has been that negotiated rates are acceptable only if they at least *match* the FCC-prescribed default rate—a clear and direct manifestation of PSP market power).

There are several inherent characteristics of the payphone services market that prevent the emergence of effective competition. As the Commission has recognized, in many markets PSPs enjoy locational monopolies, either as a result of exclusive contracts or physical realities.[8] These locational monopolies eliminate or greatly reduce the ability of callers to "shop around" for a different provider of payphone services. The situation is aggravated because locational payphone monopolies often exist in places, such as airports, hospitals and hotels, where callers do not have time to search out alternative payphones provided by another PSP that almost always never exist.

The existence of these locational monopolies enables PSPs to charge excessive coin call and "dial around" prices that far exceed the true economic costs of using their phones. Thus, despite the Commission's "deregulation" of local coin rates, it appears that every major PSP, including all LECs, have increased coin rates to the $0.35 default rate with little if any loss of usage. Further aggravating this absence of price competition is the practice of many payphone providers to not return change. Thus, for a $0.35 coin call, the effective price is often $0.50 because a caller does not get change back.

---

[8] Payphone Order at ¶¶ 59-61. For example, not many premise owners are willing to install multiple payphones provided by different service providers in a single location. Even at the Commission itself, a quick examination of the payphones on each floor of 1919 M Street illustrates that a single PSP serves the Commission's headquarters offices. If the Commission is unmotivated to, unwilling or unable to have payphones installed by multiple PSPs, it is extremely unlikely that for-profit businesses will seek to deploy multiple payphones simply to promote payphone competition.

Ordinarily, consumers would look for competitively priced alternatives, yet that is quite unrealistic in the payphone market because both consumers and IXCs are "locked in" to a given PSP's payphone. As the Supreme Court has explained, the economics of "lock in" occur when the transaction costs of switching to a different provider are high relative to the cost of the product itself; under such scenario, a firm may profitably maintain supracompetitive prices and thus enjoy market power.[9] In the case of payphone "dial around" access calls, as noted it is typically impossible for a consumer to find an alternative provider of payphones in most areas of high payphone usage, such as airports and the like. Thus, if the consumer wanted to "shop around," the costs of switching would be relatively high in that she would expend significant time attempting to locate another phone, and often would need to travel to a different location. The ten, twenty or even thirty cents of monopoly fees associated with supracompetitive PSP charges would rarely justify such a time-consuming and costly effort to switch payphones.

Likewise, IXCs are typically locked-in to the PSP contracting to serve a particular location. Carriers must take their customer as they find them, and in today's competitive long-distance market few carriers enjoy sufficient brand recognition to retain consumer loyalty while refusing to accept payphone-originated calls. Thus, even if IXCs had the practical ability (assuming the availability of the proper ANI II coding digits) to block calls from payphones, the exercise of that power with respect to any specific PSP could mean that customers would defect to another IXC rather than change locations. Thus, as a practical matter the IXC is locked-in to the whatever specific PSPs its customer chooses to utilize.

---

[9] *See Eastman Kodak Co. v. Image Technical Services. Inc.*, 504 U.S. 451, 476 (1992).

In light of these market characteristics—which cannot be altered through Commission-mandated payphone deregulation—competition that would ensure fair compensation rates does not exist in the payphone market. Thus, the Commission should base payphone compensation on costs. As ITA as indicated previously, it does not have comprehensive access to cost data for payphone providers, but existing cost studies indicate that the appropriate level of compensation lies between 8.3 and 15 cents per call.[10] The Commission should promptly adopt a cost-based price within this range. This would finally put an end to the payphone compensation quagmire and establish a "default" rate that would be upheld by the court of appeals.

II. THE COMMISSION'S "CARRIER-PAYS" MODEL HAS NOT WORKED AND SHOULD BE DISCARDED IN FAVOR OF A CALLER-PAYS REQUIREMENT

ITA was one of the few groups of service providers that agreed with the Commission's 1996 proposal for a "carrier-pays" methodology for payphone compensation, under which each carrier is responsible for payphone charges and chooses whether, and if so how, to recover these costs from its customers. ITA originally believed that this method would provide administrative and cost efficiencies, while serving consumer needs and promoting lower payphone compensation rates. Unfortunately, the carrier-pays approach has in fact proven costly, confusing and inefficient, resulting in significant dissatisfaction by both IXCs and PSPs. It is therefore time for the Commission to discard its experiment and adopt a caller-pays model for payphone compensation.

The carrier-pays methodology was intended to be administratively efficient and less costly by eliminating transaction costs and "aggregating" payphone compensation, thus allowing

[10] ITA Comments on Remand Issues, CC Docket No. 96-128, at 7 (filed Aug. 26, 1997).

lower rates that were transparent to consumers.[11] In reality, the carrier-pays approach has not been either efficient or cost-effective. LECs and other PSPs have been unwilling to develop billing and collection arrangements for payphone compensation, leaving each IXC individually to undertake the costly and burdensome calculation of payphone usage, compensation and remittance procedures for each individual PSP. Even where this has been possible (that is, for those few LECs and PSPs that have transmitted accurate ANI coding digits identifying payphone calls), the costs of this highly decentralized process have proven far more significant than anyone first imagined, prompting IXCs to pass through far more than their actual payphone compensation obligations to reseller customers. When these bloated charges are combined with the costs associated with call tracking difficulties and flaws, it is evident that the carrier-pays method provides no benefit to small carriers or to consumers. In fact, ITA is convinced that <u>the carrier-pays approach has resulted in telecard users paying far more than they would if PSP compensation charges were paid at the "point of sale" at the payphone itself</u>.

The Commission in the past has refrained from serious consideration of a caller-pays model because it believed that requiring consumers to deposit coins in a payphone in order to make a "dial around" access code call would discourage payphone usage. Yet the reality has been that the carrier-pays approach actually shields consumers from visibility to payphone charges and forces IXCs and resellers to bear the brunt of consumer frustration with increased payphone charges through market "churn" and customer defections. As in any market (such as

[11] ITA initially supported carrier-pays because we believed that it would "minimize transaction costs and avoid unnecessary hardships on calling parties," ITA Reply Comments, CC Docket No. 96-128, at 9-10 (filed July 15, 1996), because "IXCs could aggregate [their] payments to payphone providers . . . thereby eliminate the need for small telecard service providers to invest in expensive (and unnecessary) call-tracking capabilities." ITA Comments, CC Docket No. 96-128, at 15 (filed July 1, 1996).

health care) in which consumers cannot know or are not directly responsible for the price of the product purchased, demand is unable to exert any control over price. Accordingly, the Commission's reluctance to impose a "coin" requirement on callers has directly undermined development of the competitive payphone market the Commission has envisioned.

ITA is convinced that a caller-pays model will force at least some more competition into payphone access without substantially reducing usage of payphones. We believe that our actual experience in the marketplace is far more predictive of consumer behavior than the Commission's conclusions against a caller-pays model. Since on average greater than 40% of telecard calls are initiated from payphones, the fact that ITA—which has more than 250 members, most of which are small businesses and new entrants—supports a caller-pays approach, without fearing loss of demand, should be dispositive. If ITA is willing to support a caller-pays model, the Commission should have no reservations.

Perhaps most importantly, only a caller-pays approach will actually promote payphone competition and provide a "market-based" mechanism for encouraging lower payphone rates. Because callers will be more aware of the actual costs of a call at the point of sale at each particular payphone, they could "vote with their feet" by either attempting to find another payphone, using another type of phone (e.g., using a private phone to place a toll-free call) or simply deferring the call until a non-payphone is available. The old maxim that "sunlight is the best disinfectant" applies with full force to payphone compensation. If charges are actually visible to, and paid by, consumers when they place payphone-originated calls, PSPs will have to deal directly with the consequences of inflated charges. This could motivate PSPs to access reasonable prices, and therefore promote at least some competitive forces in the payphone services market. In short, if there is ever to be any real competition in payphone access, the caller-pays methodology is the only practical way to achieve it.

CONCLUSION

For all these reasons, the competitive payphone market on which the Commission's rules are based does not, and likely cannot, exist. The Commission should therefore abandon its so-called "market-based" approach to payphone compensation and instead use a cost-based model to establish a default compensation amount in the range of 8.3 to 15 cents per call. The Commission should also discard its carrier-pays methodology for payphone compensation and adopt a caller-pays approach to compensating PSPs, in order to create more price visibility for consumers and avoid the costs, confusion and inefficiencies of the carrier-pays method.

Respectfully submitted,

By:____________________

Glenn B. Manishin
Michael D. Specht
Blumenfeld & Cohen - Technology Law Group
1615 M Street, N.W., Suite 700
Washington, D.C. 20036
202.955.6300
202.955.6460 fax

Counsel for the
International Telecard Association

Dated: July 13, 1998

CERTIFICATE OF SERVICE

I hereby certify that the foregoing comments were served this 13th day of July, 1998, by delivering a copy thereof by messenger to each of the following:

Kathryn C. Brown, Chief
Common Carrier Bureau
Federal Communications Commission
1919 M Street, N.W., Room 500
Washington, D.C. 20554

Dorothy T. Attwood, Chief (2 copies)
Enforcement Division
Common Carrier Bureau, Stop 1600A
Federal Communications Commission
2025 M Street, N.W., Room 6008
Washington, D.C. 20554

Robert W. Spangler, Deputy Chief
Enforcement Division
Common Carrier Bureau
Federal Communications Commission
2025 M Street, N.W., Room 6026
Washington, D.C. 20554

Greg Lipscomb, Esq.
Formal Complaints & Investigations Branch
Enforcement Division, Common Carrier Bureau
Federal Communications Commission
2025 M Street, N.W., Room 6336
Washington, D.C. 20554

International Transcription Services, Inc.,
1231 20th Street, N.W.
Washington, D.C. 20036

La Shawn M. Barber

La Shawn Barber